

CLIENT ALERT

## CFTC Assesses Penalty Against Sponsor of Oil and Gas Fund for Failure to Register as a CPO

September 12, 2017

### AUTHORS

Rita M. Molesworth | Paul J. Pantano, Jr. | Athena Eastwood | Deborah A. Tuchman  
Michael De Voe Piazza | Neal E. Kumar | James E. Lippert

The Commodity Futures Trading Commission recently ordered the sponsor of an oil and gas fund to pay a \$150,000 penalty for failing to register as a commodity pool operator in violation of the Commodity Exchange Act.<sup>1</sup> In addition to the penalty, the sponsor may not transact in commodity interests (including in its current holdings) until it either registers with the CFTC or claims an applicable exemption, or is otherwise not required to be registered with the CFTC.

The order alleged that beginning in 2013, W Resources, LLC solicited investments on behalf of certain funds to purchase certain crude oil and natural gas interests. According to the CFTC's order, in order to "hedge [the funds'] financial exposure" related to future oil production volumes realized from their physical oil and gas assets, W Resources traded crude oil options on the New York Mercantile Exchange. The CFTC alleged that engaging in these activities required W Resources to be registered as a CPO or qualify for a registration exclusion or exemption. Since W Resources was not registered as a CPO and had not claimed an exclusion or exemption, or otherwise been granted relief from the requirement to register, the CFTC alleged that W Resources had violated the CEA's registration requirements.

The CEA generally defines a CPO as any person who, in connection with the business of operating a commodity pool, solicits, accepts, or receives from others, funds, securities, or property "for the purpose of trading in commodity interests."<sup>2</sup>

<sup>1</sup> W Resources, LLC, Docket No. 17-24 (September 5, 2017).

<sup>2</sup> Commodity Exchange Act ("CEA"), 7 U.S.C. § 1a(11) (2012). While the CFTC has broadly construed the phrase "for the purpose of trading in commodity interests," it has provided no-action and other relief to the sponsors of vehicles that engage in only a *de minimis* amount of commodity

---

## CFTC Assesses Penalty Against Sponsor of Oil and Gas Fund for Failure to Register as a CPO

The CEA requires any CPO that uses the mails or any means or instrumentality of interstate commerce in connection with its business to register as a CPO with the CFTC, unless it can qualify for an exclusion or exemption or is otherwise not required to register.

Entering into futures or swaps to manage the commodity price risks that a company incurs in connection with the acquisition of crude oil and natural gas interests should not be considered “trading” activity. Unlike hedging, which is designed to protect against the risk of price changes, the CFTC previously stated that “trading” generally means entering into a futures or swap position “**primarily for the purpose of taking an outright view on market direction or to obtain an appreciation in value of the . . . position itself** and not primarily for hedging or mitigating underlying commercial risks.”<sup>3</sup> A company that is not engaged in “trading in commodity interests” should not be considered to be a commodity pool.

Nevertheless, the CFTC broadly interprets the definition of CPO. This case is a reminder that the CFTC will aggressively pursue potential violations of the CEA’s registration requirements. Accordingly, sponsors of oil and gas funds and other vehicles should review their structure and use of commodity interest transactions to determine whether they (i) may be required to register as a CPO, (ii) qualify for an exclusion or exemption, or (iii) should seek no-action or other relief from the registration requirement.<sup>4</sup>

If you have any questions regarding this client alert, please contact the following attorneys or the attorney with whom you regularly work.

---

<b>Rita M. Molesworth</b> 212 728 8727 rmolesworth@willkie.com	<b>Paul J. Pantano, Jr.</b> 202 303 1211 ppantano@willkie.com	<b>Athena Eastwood</b> 202 303 1212 aeastwood@willkie.com	<b>Deborah A. Tuchman</b> 212 728 8491 dtuchman@willkie.com
<b>Michael De Voe Piazza</b> 713 510 1776 mpiazza@willkie.com	<b>Neal E. Kumar</b> 202 303 1143 nkumar@willkie.com	<b>James E. Lippert</b> 212 728 8945 jlippert@willkie.com	

---

interest transactions and/or engage in such transactions for hedging purposes. Such relief has been issued to the sponsors of mortgage REITs, equity REITs, business development companies, securitization vehicles and cooperatives.

<sup>3</sup> 77 Fed. Reg. 42560, 42573–74 (July 19, 2012).

<sup>4</sup> It should be noted that if a fund is a commodity pool it would be considered a “financial end user” and, absent relief, may have to post initial and/or variation margin with respect to its uncleared swap transactions.

---

## **CFTC Assesses Penalty Against Sponsor of Oil and Gas Fund for Failure to Register as a CPO**

Copyright © 2017 Willkie Farr & Gallagher LLP.

This alert is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This alert may be considered advertising under applicable state laws.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at [www.willkie.com](http://www.willkie.com).